

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

December 18, 2002

IN RE:

KINGSPORT POWER COMPANY APPLICATION
REQUESTING FINDINGS UNDER 15 U.S.C. § 79z-5a(c)
AND REPRESENTATIONS UNDER SECURITIES AND
EXCHANGE COMMISSION POLICY

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DOCKET NO.
02-00190

ORDER MAKING FINDINGS PURSUANT TO 15 U.S.C. § 79z-5a(c)

This matter came before Chairman Sara Kyle, Director Deborah Taylor Tate, and Director Pat Miller of the Tennessee Regulatory Authority (the "Authority" or "TRA"), the voting panel assigned in this docket, at the regularly scheduled Authority Conference held on November 18, 2002 for consideration of the *Application Requesting Findings and Representations* (the "*Application*") filed by Kingsport Power Company ("Kingsport Power" or "KgPCo"), d/b/a American Electric Power ("AEP") (collectively referred to as "AEP") on February 22, 2002.

AEP's Application

In its *Application*, AEP requests that the Authority make certain findings pursuant to Section 32 of the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79z-5a(c), in connection with (1) the conversion of Columbus Power Company ("CSP") and Ohio Power Company ("OPCo") to one or more Exempt Wholesale Generator ("EWG") entities (following the transfer of these companies' transmission and distribution assets and related liabilities); (2) the transfer of West Texas Utilities Company's ("WTU") and Central Power &

Light Company's ("CPL") electric generating assets and other assets to one or more newly-formed, affiliated EWG entities; and (3) the eligibility of Public Service Company of Oklahoma's ("PSO") Northeast Units 3 and 4 for EWG status either prior to or upon the transfer of those units to a non-affiliate entity. The *Application* explains that the requested findings are necessary before the affiliates of Kingsport Power owning such generating facilities will be certified as EWGs by the Federal Energy Regulatory Commission ("FERC"). The *Application* states that OPCo, CSP, CPL, WTU, and PSO are public utility company affiliates of Kingsport Power, as those terms are defined in 15 U.S.C. § 79b.¹

AEP's request stems from regulatory actions by the Public Utilities Commission of Ohio ("PUCO"), the Public Utilities Commission of Texas ("PUCT"), and FERC. The *Application* states that CSP and OPCo, which are regulated utility affiliates of Kingsport Power that provide retail electric service to customers in Ohio, are subject to Ohio's electric industry restructuring legislation.² This legislation requires CSP and OPCo to implement a Corporate Separation Plan, the purpose of which is to separate fully the provision of noncompetitive retail electric service from the provision of other services. The PUCO has approved CSP's and OPCo's Corporate Separation Plan within the context of CSP's and OPCo's overall transition plan.³

According to the *Application*, the Transition Plan approved by the PUCO requires CSP and OPCo to transfer their electric transmission and distribution assets and obligations to newly-formed entities which will continue to provide regulated service for distribution to retail

¹ In addition, AEP requested in its *Application* that the TRA make certain representations to the Securities and Exchange Commission ("SEC") in order that the SEC can approve an increase in AEP's investment authority for EWG and Foreign Utility Company ("FUCO") investments, as contemplated by 17 C.F.R. § 250.23. AEP specifically requested that the TRA advise the SEC that the TRA is aware of AEP's request before the SEC and certify that, if the SEC approves AEP's request, the TRA has the authority and jurisdiction to protect ratepayers in Tennessee and intends to exercise such authority. In a letter dated August 16, 2002, the TRA made the requested representation to the SEC.

² Ohio Rev. Code Ann. § 4928.01 *et seq.*

³ *In Re: Columbus Southern Power Company*, Public Utilities Commission of Ohio Case No. 99-1729-EL-ETP and *Ohio Power Company*, Case No. 99-1730-EL-ETP, *Opinion and Order* (September 28, 2000).

customers and will participate, with their transmission assets, in a regional transmission organization. CSP and OPCo will then become entities exclusively engaged in the sale of electric energy at wholesale.

The *Application* further states that WTU and CPL, which are regulated utility affiliates of KgPCo that provide retail electric service to customers in Texas, are subject to the Texas Utility Restructuring Act.⁴ This Act requires WTU and CPL to implement Business Separation Plans, the purpose of which is to separate the provision of competitive retail electric services from the provision of regulated transmission and distribution services. The PUCT has approved these Business Separation Plans within the context of WTU's and CPL's overall Transition Plans.⁵

The *Application* states that pursuant to their approved plans, WTU and CPL will transfer their generating assets to one or more newly-formed entities which will be exclusively engaged in the sale of electric energy at wholesale, and the PUCT will no longer have regulatory authority over these generation assets.

The *Application* also states that pursuant to FERC's Order in *American Electric Power Company, Central and South West Corporation*, 90 F.E.R.C. ¶ 61,242 (March 15, 2002), AEP is obligated to divest its ownership interest in PSO's Northeast Units 3 and 4 to a non-affiliated entity to mitigate market power concerns.

Thus, the *Application* shows that regulatory actions by the PUCO, PUCT, and FERC require the separation of various generation assets of Kingsport Power's Ohio and Texas affiliates as part of a regulatory scheme under which those assets will no longer be subject to

⁴ Tex. Util. Code Ann. § 39.001 *et seq.*

⁵ *In Re: Application of Central Power and Light Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA Sec. 39.201 and Public Utility Commission Substantive Rule Sec. 25.344*, PUCT Docket No. 22352, *Final Order* (October 5, 2001); *In Re: Application of West Texas Utilities Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA Sec. 39.201 and Public Utility Commission Substantive Rule Sec. 25.344*, PUCT Docket No. 22354, *Final Order* (October 25, 2001).

state regulatory oversight. An additional result of this separation is that AEP is required to obtain FERC designation of the separated generation assets as EWGs under the PUHCA.

A list of the affected generating plants is attached to the *Application* as Exhibit 1. The separation and designation as EWG involves twelve (12) CPL generating facilities located in Texas, thirteen (13) CSP generating facilities located in Ohio, nineteen (19) OPCo generating facilities located in Ohio, two (2) PSO generating units located in Ohio, and eleven (11) WTU generating facilities located in Texas.

Requirement of Action by the Authority

15 U.S.C. § 79z-5a(a)(1) defines "exempt wholesale generator" as follows:

The term "exempt wholesale generator" means any person determined by the Federal Energy Regulatory Commission to be engaged directly, or indirectly through one or more affiliates as defined in section 79b(a)(11)(B) of this title, and exclusively in the business of owning or operating, or both owning and operating, all or part of one or more eligible facilities and selling electric energy at wholesale.

This section further provides:

No person shall be deemed to be an exempt wholesale generator under this section unless such person has applied to the Federal Energy Regulatory Commission for a determination under this paragraph. A person applying in good faith for such a determination shall be deemed an exempt wholesale generator under this section, with all of the exemptions provided by this section, until the Federal Energy Regulatory Commission makes such determination.

15 U.S.C. § 79z-5a(2) defines "eligible facility":

The term "eligible facility" means a facility, wherever located, which is either-- (A) used for the generation of electric energy exclusively for sale at wholesale, or (B) used for the generation of electric energy and leased to one or more public utility companies; *Provided*, That any such lease shall be treated as a sale of electric energy at wholesale for purposes of sections 824d and 824e of Title 16. Such term shall not include any facility for which consent is required under subsection (c) of this section if such consent has not been obtained. Such term includes interconnecting transmission facilities necessary to effect a sale of electric energy at wholesale. For purposes of this paragraph, the term "facility"

may include a portion of a facility subject to the limitations of subsection (d) of this section and shall include a facility the construction of which has not been commenced or completed.

15 U.S.C. § 79z-5a(c) provides:

If a rate or charge for, or in connection with, the construction of a facility, or for electric energy produced by a facility (other than any portion of a rate or charge which represents recovery of the cost of a wholesale rate or charge) was in effect under the laws of any State as of October 24, 1992, in order for the facility to be considered an eligible facility, **every State commission having jurisdiction over any such rate or charge must make a specific determination that allowing such facility to be an eligible facility (1) will benefit consumers, (2) is in the public interest, and (3) does not violate State law; *Provided*, That in the case of such a rate or charge which is a rate or charge of an affiliate of a registered holding company:**

(A) such determination with respect to the facility in question shall be required from every State commission having jurisdiction over the retail rates and charges of the affiliates of such registered holding company; and

(B) the approval of the Commission under this chapter shall not be required for the transfer of the facility to an exempt wholesale generator.⁶

Thus, conversion to EWG status requires FERC approval conditioned upon certain findings by the state commissions. Conversion to EWG status removes the generation facilities designated as EWGs from the restrictions of the PUHCA, which requires holding companies that own securities in a public utility to register with the SEC and to obtain SEC approval before issuing or selling any securities. In 1992, Congress adopted the Energy Policy Act, which amends the PUHCA to make it easier for holding companies to invest in generating facilities. Such facilities, called EWGs, are exempt "from all provisions of [the PUHCA]." 15 U.S.C. § 79a-5a(e). 15 U.S.C. § 79z-5a(g) further permits holding companies "to acquire and hold the securities, or an interest in the business, of one or more [EWGs]" without the need to apply for or receive approval from the SEC.

⁶ (Emphasis provided).

Information Provided by AEP in Support of Its Application

In its *Application*, AEP addressed the requested findings with the following statement:

Allowing the generating units listed on Exhibit 1 to be designated as eligible facilities for EWG purposes will benefit consumers and is in the public interest. Consumers in every state into which electric energy can be delivered from the generating units that KgPCo is requesting be found to be eligible facilities, including Tennessee, will benefit regardless of whether the retail customers in any given state have the right to choose a retail generation provider. Introducing additional resources exempt from regulation under the Act into the competitive wholesale market will improve liquidity and help create a more robust marketplace both at the wholesale and retail levels. Consumers in Ohio and Texas will further benefit to the extent that the public policy embodied in the Ohio and Texas electricity restructuring acts is fostered. Finally, the implementation of the FERC's Merger Order regarding the market power mitigation sale of PSO's Northeast Units 3 and 4, which will be facilitated greatly by the TRA making the findings requested herein, will also further enhance competition in the relevant markets. Because it will result in benefits to consumers in many states, including Tennessee, allowing the generating units listed on Exhibit 1 to be designated as eligible facilities for EWG purposes is in the public interest.

A determination that the generating units listed on Exhibit 1 are eligible facilities will not violate Tennessee law. There is nothing in the law that prevents such a determination. Moreover, none of the generating units covered by this request are located in Tennessee, owned by KgPCo, or subject to the jurisdiction of the TRA.⁷

On May 23, 2002, the Authority issued a data request to AEP in order to elicit additional support for the requested finding that specifically addressed the impact of the EWG conversion on Tennessee consumers. AEP's reply, contained in a letter dated June 20, 2002, states:

At the outset, KgPCo can emphatically state that the proposed designation being sought from the TRA (i.e. that the generating facilities listed on Exhibit 1 to KgPCo's Application be designated as eligible facilities for EWG purposes) will not adversely affect KgPCo's retail rates for electric service. KgPCo is a subsidiary of American Electric Power Company, Inc. (AEP) and purchases the electricity that is consumed by its Tennessee retail customers from another AEP subsidiary, Appalachian Power Company (APCo), at rates approved by the FERC. Simply stated, the proposed designation will have no effect on either the existing power supply agreement between KgPCo and APCo, or the FERC-approved rates that APCo charges KgPCo for power.⁸

⁷ *Application*, February 22, 2002, p. 5.

⁸ Letter from T. Arthur Scott, Jr. to David Waddell, June 20, 2002, p. 2.

AEP further states:

APCo, along with four other AEP operating subsidiaries that own generation, currently operate as an integrated system pursuant to the FERC-approved AEP Interconnection Agreement (the Pool). While there is currently pending before the FERC a proposal to modify the Pool and reduce its membership from five to three AEP companies, APCo would continue to be a member of the surviving Pool.

The purpose of the Pool is to assure a reliable, adequate and economical supply of power and energy to its members, and the customers of each of its members, including wholesale customers of APCo such as KgPCo. Each Pool member's internal and firm energy requirements (which include the energy requirements of KgPCo's retail customers) are economically met by a combination of that member's own generating resources, Pool energy and purchases from non-Pool or non-affiliated companies (i.e. wholesale purchases). Wholesale purchases of energy from non-Pool companies are made by the Pool when the cost of those purchases is less than the cost of internal generation or Pool energy. In this way the Pool and its members, including APCo, are constantly striving to minimize the costs of power that must ultimately be borne by its customers, including KgPCo.⁹

By letter dated August 30, 2002, the Authority issued a second data request, which requested that AEP state "[w]hat assurances, if any, is AEP prepared to give the TRA concerning the prices it will charge KPC for electric generation, or, in the alternative, concerning KPC's ability to purchase power in a competitive marketplace." In addition, the Authority asked AEP to "provide any research or cost benefit analyses AEP has that support the conclusion that Tennessee consumers will benefit from EWG conversion, including cost projections for EWGs in comparison to AEP's current and projected generation costs."¹⁰

At AEP's request, in lieu of a written response, representatives of AEP met on October 8, 2002 with members of the Authority Staff to provide additional support for the *Application*. At this meeting, AEP explained that no cost benefit analysis is available regarding the conversion of regulated generation facilities to EWG status. AEP elaborated on the Pool mentioned in AEP's

⁹ *Id.*, pp. 2-3.

¹⁰ *Id.*

June 20, 2002 letter. According to AEP, two Ohio companies have left the Pool as a result of the

Ohio deregulation legislation that has necessitated designation of AEP's Ohio generation plants as EWGs. AEP stated that there would be no change in the power supply contracts for Kingsport Power. Before the conversion of the Ohio plants to EWG status and their removal from the Pool, Kingsport Power received 99.9% of its wholesale supply from APCo. According to AEP, this will be the same after the conversion and the reduction of the Pool to three members.

AEP pointed out that Kingsport Power has an "evergreen" contract with APCo which contains a three-year notice provision, and APCo has not given notice of termination to Kingsport Power. AEP further pointed out that the supply of wholesale power to Kingsport Power continues to be regulated by FERC. APCo sells wholesale power to Kingsport Power pursuant to a FERC-approved rate schedule. APCo serves approximately 98% of its load, including Kingsport Power, with purchases of power from the Pool. APCo purchases the remaining 2% on the wholesale power market. AEP contends that the conversion of the Ohio generating plants to EWGs, which places this generating capacity in the wholesale power market, will improve the wholesale market by expanding it. Because APCo purchases from the wholesale market when market prices are better than Pool prices, an improved wholesale market will mean somewhat better prices are available to APCo. Accordingly, AEP contends that the conversion of Ohio plants to EWGs and the reduction of the Pool will have either no effect on Kingsport Power's customers or a slight positive effect as a result of better prices on the wholesale market.

At the October 8, 2002 meeting, AEP supplied information regarding the capacity of the three-member Pool. This information shows that following the EWG conversion and reduction of the Pool, Kingsport Power will still be served by a Pool that draws on nearly 13,000

megawatts of generation capacity. AEP sent additional information with a follow-up letter dated October 23, 2002, which includes a comparison of costs between the five-member Pool and the three-member Pool. This comparison shows only minor variations in the cost per megawatt hour between the two Pool configurations, with neither showing an absolute cost advantage going forward.

AEP is seeking a finding pursuant to 15 U.S.C. § 79z-5a in Tennessee and ten other states. Information supplied by AEP shows that the Indiana, Virginia, Texas, and Ohio commissions have made the requested finding, and AEP is still awaiting commission action in Kentucky, Arkansas, Louisiana, Oklahoma, West Virginia, and Michigan.

Findings and Conclusions

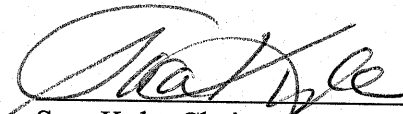
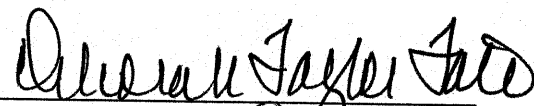

Although the Authority would have preferred a thorough cost benefit analysis of the effects of the proposed conversion to EWG status, the Authority finds that the proposed conversion will not have an appreciable negative effect on, and may indeed produce some benefits for, AEP's Tennessee customers. The most significant aspect of the proposed conversion is the reduction of the Pool from which Kingsport Power's supplier, APCo, purchases wholesale power from five members to three. The five member Pool has an almost even balance between capacity and load, with the Pool making up any difference through purchases from the wholesale market depending on market prices. The three member Pool enjoys a similar balance between capacity and load. Thus, reduction in the size of the Pool poses little risk that Kingsport Power's customers will be subject to the uncertainties of the wholesale market. There should thus be little impact on Kingsport Power's wholesale supply situation as a result of the EWG conversion and reduction of the Pool. If anything, as AEP asserts, Kingsport Power's retail customers may see some benefit from a broader and more varied wholesale market. Finally, the

Authority sees little reason to expect any significant effect on Tennessee consumers from the conversion of AEP's Texas generating facilities to EWG status.

Therefore, upon careful review of AEP's *Application*, the Authority finds pursuant to 15 U.S.C. § 79z-5a(c) that that allowing the generating facilities designated in AEP's *Application* to be eligible facilities, or EWGs, will benefit consumers, is in the public interest, and does not violate State law. At the November 18, 2002 Authority Conference, the voting panel unanimously voted to approve AEP's *Application*.

IT IS THEREFORE ORDERED THAT:

The *Application Requesting Findings and Representations* filed by Kingsport Power Company, d/b/a American Electric Power is approved.


Sara Kyle, Chairman
Deborah Taylor Tate, Director
Pat Miller, Director